



FASB Changes Presentation of Not-for-Profit Financial Statements

A new FASB Accounting Standards Update (ASU) changes how not-for-profit entities (NFPs), including health care entities, report net asset classes, expenses, and liquidity in their financial statements.¹

The FASB deferred to Phase 2 of its project on NFP financial statements the decision about requiring a measure of operations in the statement of activities.²

Key Facts

- The ASU:
 - Reduces the number of net asset classes presented from three to two: *with donor restrictions* and *without donor restrictions*;
 - Requires all NFPs to present expenses by their functional *and* their natural classifications in one location in the financial statements;
 - Requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and
 - Retains the option to present operating cash flows in the statement of cash flows using either the direct or indirect method.

Key Impacts

- Eliminating the distinction between temporary and permanent restrictions will reduce reporting complexity and enhance understandability.
- Presenting expenses by nature and function will provide financial statement users with greater transparency about how an NFP uses its resources.
- Enhancing liquidity and availability disclosures is intended to provide financial statement users with additional information about how an NFP manages its cash needs and how limits on resources may affect liquidity and financial flexibility.

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¹ [FASB Accounting Standards Update 2016-14](#), Presentation of Financial Statements of Not-for-Profit Entities, available at www.fasb.org.

² More information about the [FASB's NFP project](#) is available at www.fasb.org.



While some NFPs currently opt to disclose information about *board-designated net assets*, U.S. GAAP before the new ASU did not require these disclosures except for endowment funds.

The ASU requires NFPs to disclose information about *all* board-designated net assets, including those designated for a specific future expenditure.

Changes to Net Asset Classification

The FASB replaced the three existing net asset classes with two new net asset classes that eliminate the distinction between temporary and permanent restrictions. This change will reduce confusion caused by changes in state laws that deemphasized the historic dollar (original gift) value for endowments in most jurisdictions.

Current U.S. GAAP	ASU
<ul style="list-style-type: none"> • Unrestricted • Temporarily Restricted • Permanently Restricted 	<ul style="list-style-type: none"> • Net Assets Without Donor Restrictions • Net Assets With Donor Restrictions

The ASU retains the current U.S. GAAP requirement for NFPs to disclose the nature and amounts of donor-imposed restrictions. These disclosures will now focus on how and when the resources can be used rather than applying a bright-line distinction between temporary and permanent restrictions. The ASU also requires NFPs to disclose the amounts and purposes of board designations of *net assets without donor restrictions*.

Underwater Endowments

The fair value of an individual donor-restricted endowment fund may be less than the amount of the original gift or the amount that the donor or law requires the NFP to maintain. Currently, NFPs report this deficiency in *unrestricted* net assets. Under the ASU, NFPs will report this deficiency in *net assets with donor restrictions*.

NFPs currently must disclose the aggregate amount by which endowment funds are underwater. The ASU requires additional disclosures about underwater endowments in the aggregate:

- The original gift amount (or level required by donor stipulations or law) of underwater endowment funds; and
- The fair value of underwater endowment funds.
- The ASU also requires an NFP to disclose (1) its interpretation of its ability to spend and (2) its policy, and actions it took during the period, concerning appropriation from underwater endowment funds.

Reporting Expenses by Function and Nature

Under current U.S. GAAP, all NFPs must present expenses by function; however, only voluntary health and welfare entities must also present expenses by nature. The ASU requires all NFPs to report expenses by function *and* nature in one location on the face of the statement of activities, as a schedule in the notes, or in a separate financial statement. NFPs must show the relationship between the functional and natural classifications by disaggregating the



The FASB will explore in Phase 2 of this NFP project or in a future project whether NFP business-oriented health care entities should provide disaggregated information by segments instead of by functional classification.

functional categories by their natural classifications. NFPs could present this expense analysis in a matrix; however, the ASU prescribes no specific format.

Voluntary health and welfare entities, which currently must present a statement of functional expenses, will have the same flexibility in presentation as other NFPs.

Additional Disclosures about Expense Allocations

NFPs are currently required to allocate expenses that are attributable to more than one program or supporting activity. The ASU requires NFPs to provide qualitative disclosure about the methods used to allocate those expenses.

The ASU refines the definition of *management and general activities* and includes additional examples of the types of activities included in that category (e.g., payroll and human resources). The ASU also includes additional implementation guidance to better depict which activities represent *direct conduct* and *direct supervision* of program or supporting activities, and would be allocated to the program and support functions that benefit.

Presentation of Investment Return and Expenses

The ASU requires NFPs to net investment expenses against investment return, thereby eliminating the option for gross presentation. The netted investment expenses are limited to external and direct internal investment expenses incurred during the period. Under the ASU, NFPs are no longer required to disclose the amount of investment expenses or the components of gross investment return. The ASU also precludes NFPs from including the netted investment expenses in the expense analysis.



Availability of a financial asset may be affected by its nature; external limits imposed by donors, law, and contracts with others; or internal limits imposed by governing board decisions.

Liquidity and Availability Disclosures

The ASU requires NFPs to provide additional information about liquidity and availability of financial resources. The ASU includes illustrative disclosures.

Liquidity Information	Availability Information
Qualitative information in the notes about how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date	Quantitative information either on the face of the balance sheet or in the notes, and additional qualitative information in the notes as necessary, about the availability of an NFP's financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the balance sheet date

Other Changes



NFP business-oriented health care entities currently report equity transfers as a separate line outside the performance indicator. The ASU does not change this presentation.

Topic	Key Details
<ul style="list-style-type: none"> Statement of Cash Flows 	<ul style="list-style-type: none"> NFPs retain the option to present operating cash flows using the direct or indirect method NFPs that opt to use the direct method no longer need to include a reconciliation of the change in net assets to cash flows from operating activities
<ul style="list-style-type: none"> Intermediate Measure of Operations 	<ul style="list-style-type: none"> NFPs that present a self-defined measure of operations that includes internal transfers report these transfers appropriately disaggregated and described by type on the face of the financial statements or in the notes Transfers include those arising from board designations, appropriations, and similar actions
<ul style="list-style-type: none"> Expiration of Restrictions on Long-Lived Assets 	<ul style="list-style-type: none"> Eliminates the option to release restrictions over the estimated useful life of the asset Restrictions are released when the asset is placed in service, unless there are explicit donor restrictions indicating otherwise
<ul style="list-style-type: none"> Equity Transfers (i.e., between a parent and a subsidiary or entities under common control) 	<ul style="list-style-type: none"> Presented as a separate line item on the statement of activities by all NFPs The ASU does not explicitly require NFPs to label equity transfers using this term, and still permits other terms (e.g. <i>grant from affiliate</i>)

Effective Date and Transition

This ASU is effective for annual periods in fiscal years beginning after December 15, 2017, and for interim periods in fiscal years beginning after December 15, 2018.

The ASU permits early application, and is applied retrospectively in the year of adoption. NFPs that present comparative financial statements may omit certain information for periods presented before the year of adoption:

- Analysis of expenses by functional and natural classification; and
- Disclosures about liquidity and availability of resources.

In the year of adoption, NFPs should disclose the nature of reclassifications or restatements and their effects, if any, on changes in the net asset classes for each year presented.

Next Steps

This ASU is the culmination of Phase 1 of the FASB's project to improve NFP financial reporting. The FASB deferred decisions about other changes included in the proposed ASU, specifically those requiring all NFPs to present intermediate measures of operations (as defined by the FASB) to Phase 2 of the NFP financial statements project.³ The FASB has not said when it will complete Phase 2.

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³ [FASB Proposed Accounting Standards Update](#), Presentation of Financial Statements of Not-for-Profit Entities, April 22, 2015, available at www.fasb.org.